

MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES MEETING

Dr. Richard Abernathy, Chair

Monday, June 6, 2011

1:00 p.m.

1400 West Third Street
Little Rock, AR 72201

Board Members Present

Dr. Richard Abernathy, Chair
Hazel Coleman, Vice Chair
David Cauldwell
Peggy Gram, designee for Honorable
Charlie Daniels
Dr. Tom Kimbrell*
Beverly Leming
Bobby Lester*
Susannah Marshall, designee for Candace
Franks
Donna Morey
Janelle Riddle
Honorable Martha Shoffner
Jeff Stubblefield
**via teleconference*

Board Members Absent

Lloyd Black
Robin Nichols

Guests Present

Shane Benbrook, Audit Committee Member
Chris Caldwell, Division of Legislative Audit
Lawrence Colston, Ex Trustee Member
Dale Coy, Audit Committee Member
Sarah Ganahl, Bureau of Leg. Research
Erika Gee, Attorney General's Office

Staff Present

George Hopkins, Executive Director
Gail Bolden, Deputy Director
Brent Barrett, Senior Software Specialist
Kay Daniel, Director's Assistant
Dena Dixon, Risk Mgmt/Internal Audit
Reed Edwards, Litigation Attorney
Vicky Fowler, Interim Dir. Human Resources
Laura Gilson, General Counsel
Amy Glavin, Administrative Assistant
Rod Graves, Ret. Investment Specialist
Wayne Greathouse, Dir. Public Markets
Manju, Dir. Data Processing
Jerry Meyer, Dir. Real Estate
Michael Ray, Dir. Member Services
Kathleen Scoggins, Retirement Section Mgr.
Gaye Swaim, Operations Administrator
Leslie Ward, Dir. Private Equity
Brenda West, Risk Mgmt/Internal Audit

Consultants Present

Michael Bacine, Franklin Park
P. J. Kelly, Hewitt EnnisKnupp
Eric Kuhl, Hewitt EnnisKnupp

Reporters Present

Mike Wickline, Arkansas Democrat Gazette

- I. **Call to Order/Roll Call.** Chair, Dr. Richard Abernathy, called the Board of Trustees meeting to order at 1:00 p.m. Roll call was taken. Lloyd Black and Robin Nichols were absent. Dr. Tom Kimbrell and Bobby Lester were absent from the meeting but called in via teleconference during the meeting.

II. **Motion to Excuse Absences.**

Ms. Coleman moved to excuse Lloyd Black and Robin Nichols from the June 6, 2011, Board of Trustees meeting. Ms. Riddle seconded the motion, and the Board unanimously approved the motion.

III. **Adoption of Agenda.**

Ms. Leming moved for adoption of the Agenda. Ms. Coleman seconded the motion and the Board unanimously approved the motion.

IV. **Executive Summary.** The Executive Summary was provided for reference with no questions or expansions on the written summary.

V. **Approval of Board of Trustees Minutes.**

A. **Minutes of April 4, 2011.**

Ms. Coleman moved for approval of the Minutes of the Board of Trustees meeting of April 4, 2011. Ms. Leming seconded the motion, and the Board unanimously approved the motion.

B. **Minutes of May 23, 2011.**

Ms. Leming moved for approval of the Minutes of the Board of Trustees meeting of May 23, 2011. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

VI. **Adoption of Interest Rate for T-DROP Accounts for 2011-2012 (Resolution No. 2011-19).** Mr. Hopkins explained to the Board that it is time to set interest rates for the 2011-2012 fiscal year for active T-DROP accounts. The interest rate is based upon investment returns in the fiscal year. Because ATRS investments to date have exceeded 8%, the rate can be set at the maximum of 6%.

Ms. Coleman moved to adopt Resolution No. 2011-19, determining the T-DROP account interest rate for 2011-2012 at 6%. Ms. Gram seconded the motion, and the Board unanimously adopted the resolution.

VII. **Adoption of Interest Rate for Post 10-Year T-DROP Accounts for 2011-2012 (Resolution No. 2011-20).** Mr. Hopkins explained to the Board that it is time to set interest rates for the 2011-2012 fiscal year for post 10-year T-DROP accounts. The interest rate is based upon investment returns in the

fiscal year. Because ATRS investments to date have exceeded 8%, the rate can be set at the maximum of 6%.

Ms. Leming moved to adopt Resolution 2011-20, determining the post 10-year T-DROP account interest rate for 2011-2012 at 6%. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

VIII. **Investment Committee Report.** Ms. Leming gave a report on the Investment Committee Meeting

A. **Arkansas Holdings Update.**

1. **Victory Building Electrical Engineering Report.** At the April 4, 2011, Board meeting, there was discussion regarding the engineering aspects and contractual obligations of KARK. After an electrical engineering analysis, ATRS staff found that a one-time fee of approximately \$4,000 would be required for installation of a monitoring device. This would increase income to ATRS of an amount between \$2,900 and \$3,000 per year. ATRS staff recommends moving forward to monitor electrical usage. The Board had no objection to the Committee's recommendation.

There was also concern about the chilled water usage by KARK. Analysis revealed that the air conditioning system needs to run constantly, regardless of tenant. It would cost \$12,000 to monitor the chilled water usage, but because the lease does not address chilled water usage, ATRS would not be able to recoup or charge any cost to KARK.

Another concern of the Board was the square footage issue. When the Victory Building was built, it was initially believed to be 247,822 square feet. In actuality, according to Building Owners and Managers Association (BOMA) standards, the building's actual measurement is 262,000 square feet. The lease with KARK states that 29,546 square feet is allocated to KARK and that is the amount upon which rent is charged. ATRS staff will examine the KARK lease to see if charging for more square footage is allowed.

ATRS received a lien notice in regards to equipment KARK had purchased. KARK purchased the equipment from a contractor, who sub-contracted installation to another company. A dispute arose between the contractor and sub-contractor, resulting in attempts to place a lien on the building. KARK's parent company, Nexstar, told

ATRS that they would pay the lien so that they would not be in fault of their lease.

ATRS staff will undertake the initiatives to monitor the electrical usage, in the building. ATRS staff will also pay a courtesy call to KARK to see if they will unilaterally agree to increase the rent due to past mistakes in measurements of the space. The Board will receive a full copy of the lease with KARK for review. An update of the square footage issue will be at the next Committee and Board meetings.

2. **Other Developments on Arkansas Investments.** The Arkansas Supreme Court held oral arguments regarding the ATRS tax case. The Arkansas General Assembly passed an act that states that ATRS did not have to pay local taxes, however Arkansas Case law states that the Arkansas Supreme Court cannot grant an exemption unless it is already in the Arkansas Constitution. A decision should be reached before the Supreme Court is released on summer recess.

There is also another case suit in regards to usury amendments. Voters approved amendments that would set Arkansas usury rates back at 17%. ATRS had suspended loan programs due to uncertainty in the usury amendment. The Peabody Hotel group has asked ATRS for another loan totaling \$7 million for renovations. ATRS will not consider any further loans until a decision by the Arkansas Supreme Court is reached.

Woodland Heights continues to increase in occupancy and bring in cash flow.

B. General Investment Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Quarter Ended March 31, 2011.** The total fund underperformed its benchmark of 4.6% for the quarter at 4.2%. U.S. Equity outperformed its benchmark of 6.4% for the quarter at 7.8%. The U.S. Equity portfolio also bested the performance benchmark over 1, 3, 5, and 10 year periods, producing a number one rank. Global equity also underperformed its benchmark of 4.4% for the quarter at 3.3%. Fixed income outperformed its benchmark of 0.7% for the quarter at 1.8%.
2. **Portfolio Performance Update for the Month Ended April 30, 2011.** The total fund underperformed its benchmark of 2.5% for the month at 2.4%. Total U.S. equity underperformed its benchmark of 3.0% for the month at 2.8%. Total global equity underperformed its benchmark of

4.1% for the month at 4.0%. Total fixed income outperformed its benchmark of 1.3% for the month at 1.4%.

3. **Risk Overview of the Total Fund.** As of March 31, 2011, the total plan risk is at 2.78%. The majority of the active risk comes from fixed income portfolios. The Investment Committee recommends lowering the risk percentage to 2.59%. This would be done by withdrawing \$50 million each from ICC Capital, Kennedy, and Nicholas Applegate and use the funds to seed a new, highly liquid, low cost U.S. Equity index fund. Capital Guardian would be liquidated for \$360 million and placed into a global index fund. \$175 million would be drawn from BlackRock, Western Core, Western Absolute Return, and Loomis Sayles and transferred to the bond index fund.
4. **Liquidity Options for the Total Fund.** Arkansas Teacher Retirement System (ATRS) has extensive cash flow needs throughout the year. The plan has three traditional asset classes from which to draw resources: U.S. equity, global equity, and fixed income. ATRS does not have a "go-to" liquidity option in U.S. equity and the current global equity index fund is only open bi-monthly, which is insufficient for ATRS' needs. A standalone commingled fund option would be the lowest cost to ATRS to provide liquidity in the U.S. markets. The Investment Committee recommends adding a U.S. daily-valued commingled index fund and a global weekly-valued commingled index fund, both from BlackRock.
5. **Risk Analysis for Fixed Income Portfolio.** Hewitt EnnisKnupp provided stress test scenarios on the ATRS fixed income portfolio and an analysis regarding the expected price change of underlying fixed income portfolios given changes in interest rates and spreads.
6. **Proposed Rebalancing of Fixed Income Portfolio Between Passive and Activist Managers (Resolution No. 2011-21).** Hewitt EnnisKnupp and ATRS staff recommended lowering the activist risk profile by a series of fund transfers to more passive managers. \$25 million from BlackRock, \$50 million from Western Core, \$50 million from Western Absolute Value, and \$50 million from Loomis Sayles to BlackRock funds. This would lower the total class risk from 4.02% to 3.50%.

Ms. Leming moved to adopt Resolution No. 2011-21, authorizing Hewitt EnnisKnupp to rebalance the fixed income portfolio from active to passive funds, lowering the total class risk from 4.02% to 3.50%. Ms. Gram seconded the motion, and the Board unanimously adopted the resolution.

7. **Termination of Capital Guardian Trust Company – ATRS All Country World Equity Portfolio (Resolution No. 2011-22).** Hewitt Ennisknupp researchers have downgraded their opinion of the firm and its underlying strategies. There has been a turnover rate for investment talent, their assets under management have shrunk since 2007, and their performance has been lacking over recent years. The Investment Committee recommended termination of Capital Guardian Trust Company and placing the \$360 million in an existing or more liquid global index fund.

Ms. Leming *moved to adopt* Resolution No. 2011-22, approving the termination of Capital Guardian Trust Company – ATRS All Country World Equity Portfolio. Ms. Riddle *seconded the motion*, and the Board *unanimously adopted the resolution*.

8. **Recommendation to Commit to BlackRock MSCI ACWI IMI Index Fund A and to use Imminent Need Funding to Replace Capital Guardian (Resolution No. 2011-23).** The Investment Committee recommended a commitment to BlackRock MSCI ACWI IMI Index Fund A because of its weekly liquidity, broad market coverage, superior fee schedule, and large asset base. Though ATRS has exposure in State Street, funds in BlackRock will limit business risk. Imminent need funding would be required.

Ms. Leming *moved to adopt* Resolution No. 2011-23, approving a commitment to BlackRock MSCI ACWI IMI Index Fund A to replace Capital Guardian and to use imminent need funding. Ms. Morey *seconded the motion*, and the Board *unanimously adopted the resolution*.

9. **Recommendation to Commit to Blackrock U.S. Equity Market Fund A and to use Imminent Need Funding (Resolution No. 2011-24).** The Investment Committee recommended a commitment to BlackRock U.S. Equity Market Fund A because of its daily liquidity, superior fee schedule, and large asset base. Though ATRS has exposure in State Street, funds in BlackRock will limit business risk. Imminent need funding would be required. Up to \$50 million each from ICC Capital Management, Kennedy Capital Management, and Allianz (Nicholas Applegate) will be moved into this fund.

Ms. Leming *moved to adopt* Resolution No. 2011-24, approving a commitment to BlackRock U.S. Equity Market Fund A and to use imminent need funding. Mr. Cauldwell *seconded the motion*, and the Board *unanimously adopted the resolution*.

C. Real Estate Consultant Update – Hewitt EnnisKnupp.

1. **Portfolio Performance Update for the Quarter Ended December 31, 2010.** Fourth quarter trends showed several core open-end funds that had entry queues, investor interest shifted up from the risk/return spectrum, and transaction volume increased as capital become more widely available to non-core investors. The market outlook shows waning fundamental deterioration should lead to stabilizing and/or appreciating values, improved access to capital will cause transaction volume to increase, and increasing valuations may continue. Opportunities should present themselves in such areas as debt and mezzanine lending, distressed investments, and secondary market investments.

Performance of 3.6% for the quarter trailed the NCREIF Property Index of 4.6% due to the Arkansas Direct Investment portfolio, which had a flat performance for the quarter.

D. Private Equity Investment Consultant Update – Franklin Park.

1. **Private Equity Portfolio Review for the Quarter Ended December 31, 2010.** Mr. Bacine reported on the private equity portfolio review for the quarter ended December 31, 2010. The net IRR for the quarter ended December 31, 2010, was 8.2% with committed capital at approximately \$2.3 billion. The percent change in portfolio value for the quarter was 4.0%.
2. **Recommendation for Commitment to JFL Equity Investors III, L.P. (Resolution No. 2011-25).** The fund will make control investments in small and lower middle market defense, aerospace, and maritime companies in the United States and the United Kingdom and will primarily invest in corporate divestitures and acquisitions, with particular focus on suppliers to government and/or commercial markets. Franklin Park recommends this fund because it pursues a compelling investment strategy, JFL is well-positioned competitively in its target market, has a highly experienced and cohesive team, and a solid track record. The Investment Committee recommends a commitment of up to \$40 million.

Ms. Leming moved to adopt Resolution No. 2011-25, approving a commitment of up to \$40 million to JFL Equity Investors III, L.P. Ms. Morey seconded the motion, and the Board unanimously adopted the resolution.

IX. **Operations Committee Report.** Ms. Riddle gave a report on the Operations Committee meeting.

- A. **Actuarial Cost of Service Calculations.** ATRS staff felt an important decision should be made concerning the approach to charging actuarial cost for service. Two potential models can be used by ATRS in charging actuarial cost. One model essentially charges a flat percentage cost to the member, regardless of the potential benefit for the member. This model is reasonably easy to administer and to explain to members, though it does not recognize cost variation by age. The second model runs age and service based actuarial calculations with promotion of past service. This model is very difficult to explain to potential purchasers and requires complex software that needs continual updates.

Since the law allows ATRS to charge actuarial cost, ATRS staff wanted to make the Board aware that the actuaries can create a purchase model that will use either a flat rate or a relative value rate based upon additional factors that should be considered in the purchase. The Operations Committee recommended the first model that uses a flat percentage rate for its ease of use.

Ms. Riddle *moved to approve* using a flat percentage cost to calculate cost of service purchase accounts. Ms. Coleman *seconded the motion*, and the Board *unanimously approved the motion*.

B. **Potential Legislation for 2013 Session.**

1. **Credit Service during Periods of Termination and Subsequent Reinstatement.** Based upon Board discussions at the May 23, 2011, Board Meeting, it appeared that significant policy issues are involved in the wrongful termination of a school employee who is subsequently reinstated, and how service credit and other factors should be resolved. When a member is terminated, and then reinstated at a later time, they lose service credit with ATRS and miss out on a greater benefit. The Operations Committee recommended that legislation be drafted to rectify this error and requested Board input. The Board consensus was to allow the time between the termination and subsequent reinstatement to be credited to the member at actuarial cost of service.
2. **Employer Reporting Disclosure for all Salaries Paid (Representative Pennartz 2011 HB1119).** Prior to the close of the last session, ATRS staff worked with Representative Pennartz to draft what was originally a theft of salary bill into a broader bill relating to under reporting salaries and the ability of ATRS to track and obtain

contributions on all money paid to a member that should be included as salary and contributions made thereon. ATRS staff requests Board input on this issue. After lengthy discussion, the Committee requested that this agenda item be placed on the next Committee meeting agenda, and examples to given to the Committee. The Committee will report to the Board their decision.

- C. **College Participation in ATRS after Act 513.** Act 513 of 2011 greatly changed how colleges participate in ATRS. The term "colleges" is used broadly to include all ATRS employers that currently participate in ATRS that offer ATRS and an alternate plan such as TIAA CREF. Due to numerous operational problems that existed, the college legislation in Act 513 was adopted to place better controls in the relationship between ATRS and colleges. After July 1, 2011, colleges must become a post-secondary/higher education (PSHE) employer in order to enroll new employees into ATRS. By becoming a PSHE employer, colleges will be required to provide reporting at a higher level than previously existed. At the same time, colleges that decide not to become a PSHE employer may still grandfather existing employees for the remainder of existing employees' careers.

The University of Arkansas (U of A) System and its associated institutions notified ATRS that the U of A System and its institutions do not intend to become PSHE employers. The University of Central Arkansas and North Arkansas College have notified ATRS that both do intend to become PSHE employers, though there is some concern that new employees are not allowed enrollment in ATRS.

ATRS staff requests Board input on whether to put forth legislation to reinstate the ability of colleges to enroll new members into ATRS, as there appears to be a greater chance of colleges opting out of ATRS after the passage of Act 513 of 2011. The consensus of the Board was to add college legislation to the 2013 session list.

X. **Staff Reports.**

- A. **Medical Committee Report.** Mr. Ray gave the Medical Committee reports for April 2011 and May 2011. In April 2011, 14 applicants were considered, 13 were approved, and one was denied. In May 2011, 17 applicants were considered and all 17 were approved.

Ms. Coleman moved to approve the April 2011 and May 2011 Medical Committee reports. Ms. Morey seconded the motion, and the Board unanimously approved the motion.

- B. **Personnel Report.** Ms. Fowler gave the personnel report for the period of December 26, 2010, and May 28, 2011. During that time, ATRS had 851 applications, 40 interviews, three transfers, five terminations, two new hires, and three promotions. Total overtime paid during this period was \$131.92.
- C. **Financial Reports.** Ms. Scoggins presented the financial reports.
1. **Travel Report.** Total expense percentage change from 2010 to 2011 is -13.86%. The major contributing factor to the overall decrease in expenditures is attendance to one less conference in 2011 than in 2010. The overall savings between the two years was \$3,127.80.
 2. **Financial Report.** Total liabilities and reserves have gone up 11.56% in 2011 from 2010. Net income has increased 17.02% in 2011 from 2010.
 3. **Comprehensive Annual Financial Report (CAFR) Update.**
- XI. **Audit Committee Discussion.** Ms. West introduced the recently chosen Audit Committee members, Shane Benbrook, whose term is July 1, 2011 to June 30, 2013, and Dale Coy, whose term is July 1, 2011 to June 30, 2015. There was one vacant position in the Audit Committee, which was previously filled by Auditor Jim Wood. The Board appointed Honorable Charlie Daniels to the vacant Audit Committee position. The internal audit plan was given to the Board for review. The next Audit Committee meeting is planned for July 2011.
- XII. **Appointment of Trustee to Fill Unexpired Term for Retiree Position #11.** Mr. Hopkins explained that the Board has 10 Trustee applications for review. Once the Trustee has been selected, ATRS staff will begin planning for a New Board Member orientation.
- Ms. Leming *moved to appoint* Danny Knight to the Board of Trustees in Retiree Position #11, to serve as a Trustee starting July 1, 2011, to June 30, 2012. Ms. Riddle *seconded the motion*, and the Board *unanimously approved the motion*.**
- XIII. **Executive Session to Discuss Board Appointment.** Chair, Dr. Abernathy, called the Executive Session of the Board of Trustees to order at 2:00 p.m.
- Chair, Dr. Abernathy, reconvened the Board of Trustees meeting at 2:30 p.m.
- XIV. **Other Business.**

XV. **Adjourn.**

Ms. Coleman *moved to adjourn* the Board of Trustees Meeting. Ms. Marshall *seconded the motion*, and the Board *unanimously approved the motion*.

Meeting adjourned at 2:33 p.m.

George Hopkins,
Executive Director

Dr. Richard Abernathy, Chair
Board of Trustees

Amy Glavin,
Recorder

Date Approved